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## Compensation, Employee Performance, and Mediating Role of Retention: A Study of Differential Semantic Scales

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**Abstract:**

*Compensation has a high effect on employee retention within a company because with satisfactory compensation, employees will feel that the company is caring about employee needs.*

*This study examines the effect of compensation on employee performance. The study was conducted in the hospitality industry in Medan City, North Sumatra, Indonesia. A total of 200 employees from 5 hotels in Medan City were taken as sample. Data were analyzed by using SMART PLS program.*

*The results show that compensation has a significant positive effect on performance; compensation has a significant positive effect on retention; retention has a significant positive effect on performance; retention mediates the effect of compensation on performance.*

*The result of the research is expected to give different perspective and novelty to the improvement of hotel employee performance in Medan City, North Sumatra.*

**Keywords:** *compensation, employee performance, self-efficacy, retention, hospitality industry.*

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## **1. Introduction**

Compensation has a high effect on employee retention within a company because with satisfactory compensation, employees will feel that the company is caring about employee needs. Employee satisfaction will be shown by the stay of employees at the company or retention. The empirical literature has shown that the antecedent retention is compensation (Hong *et al.*, 2012; Astuti, 2014). In addition, retention is also reported to have an impact on performance (Sumarni, 2011).

The results of these studies indicate that retention has a potential mediating variable in the effect of compensation on performance. Nevertheless, it has not been the attention of researchers compared to other variables (Dito & Lataruva, 2010; Kiswuryanto & Djastuti, 2014). The argument is supported by Maslow's motivational theory (1943) which in general considers that human needs are hierarchical from the most basic needs to self-actualization.

In this study, it is assumed that granting basic rights to employees such as salaries and the provision of health and safety facilities will encourage employees to remain stay in the company. This is because, employees can maximize the fulfillment of other needs such as social and appreciation to the level of self-actualization indicated by the improvement of employee performance. This study aims to examine the effect of compensation on performance. In addition, test the role of retention as mediation in the effect of compensation on performance, and to test self-efficacy as a moderator in the effect of retention on performance.

## **2. Employee Compensation and Performance**

Compensation is all forms of financial return, services, and benefits received by workers as part of employment relationships (Milkovich *et al.*, 2002). Compensation relates to the right that an employee receives from the sacrifices made to the organization. Murty and Hudiwinarsih (2012) argue that a motivated employee will be energetic and passionate about the tasks assigned by the company, and otherwise an employee with low motivation will often display discomfort and displeasure with his/her work resulting in their performance become bad and company goals will not be achieved.

Thus, it can be said that the management of good compensation will affect the performance of employees (Grabara, 2013). On the other hand, poor compensation management will result in demotivation that ultimately affects the declining performance of employees. The argument is based on Maslow's motivational theory (1943). Maslow's motivational theory generally explains that one's motivation for his needs is hierarchical and stratified. When the basic level of needs has been achieved, someone will go up to the next level, to the level that is the ultimate self-actualization. Compensation is assumed to be the company's efforts to meet the basic needs of its employees, such as salaries, health, safety facilities, etc. With the effort

to meet these basic needs, it is expected to encourage employee motivation in terms of fulfillment needs at a higher level, such as social needs, rewards, and self-actualization. In this case, when these basic needs are met, it will encourage employees to further improve their performance. Based on these arguments can be indicated that the provision of compensation can affect employee performance.

*Hypothesis 1: Compensation positively affects on employee performance.*

### **3. Compensation and Retention**

Yensy (2010) revealed that well-managed or properly implemented compensation in the long run can be an effective tool for increasing employee morale. Hafanti (2015) states that there are ten forms of compensation for employees, namely salary, job bonus, holiday / pension allowance, family health insurance, employee involvement in insurance program, employee recreation program, awards for outstanding employees, and adequate leave periods. These forms of compensation are very concerned about things that are fundamental to the needs of employees.

Therefore, the management of good compensation to employees will affect the comfort and desire employees to stay in the organization. The argument is also supported by Maslow's motivational theory. When the fulfillment of the basic needs of the employees are met, they will tend to feel satisfied and choose to stay to meet other needs such as social needs, rewards, to self-actualize within the company. This is also supported previous research which confirms that there is significant relationship between compensation and retention (Warner, 1981; Terera and Ngirande, 2014; Hong *et al.*, 2012; Astuti, 2014; Thalassinis *et al.*, 2012; Kossova *et al.*, 2014).

*Hypothesis 2: Compensation positively affects on retention*

### **4. Employee Retention and Performance**

Retention issues focus on the reason of employee turnover in the company (Samuel & Chipunza, 2009). Mathis and Jackson (2006) argue that retention is the company's attempt to keep its employees in the organization where it aims to help achieve maximum organizational goals. Retention is a step volunteered by an organization for creating environment eligible for the employee to survive long (Samuel & Chipunza, 2009). Hasibuan (2009) argued that if the employee maintenance is well-managed by the company, the employee will have the spirit of working, disciplined and be loyal to the company.

This argument is also supported by Maslow's motivational theory that employees who are satisfied with the fulfillment of their needs will be compelled to meet the needs at a higher level. The efforts of the company in retaining employees to stay in the company will further encourage employees to perform better in order of fulfillment of higher needs. Senior employees, for example, choose to stay in the

company to meet their needs in terms of self-actualization, resulting in many senior employees who then occupy the top position because of its better performance. Based on these arguments, it can be indicated that retention can have a positive effect on employee performance.

*Hypothesis 3: Retention positively affects on employee performance.*

## **5. Compensation, Retention, and Employee Performance**

Whitt (2006) indicates that compensation will have an impact on the high retention of employees, which ultimately will affect the performance. Astuti (2004), Hong et al. (2012) has confirmed the positive effect of compensation on retention. In addition, Sumarni (2011) has also confirmed the positive effect of retention on performance. Al-Hawari (2006) revealed that consumer retention may mediate the effect of service quality on firm performance. In line with the idea, this study positions employee retention to mediate the effect of compensation on employee performance. The role of retention as a mediator in the effect of compensation on performance has not been widely discussed in the literature.

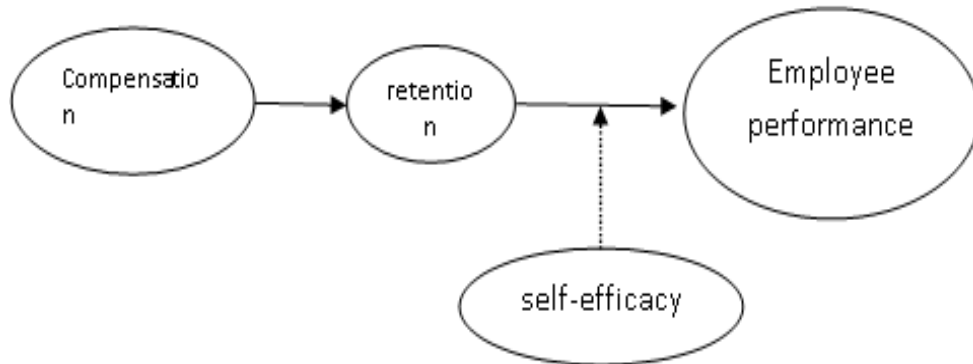
*Hypothesis 4: Compensation mediates positive influence of retention on employee performance.*

## **6. Retention, Employee Performance, and Self Efficiency**

In social cognitive theory there are triadic elements, i.e behavior, environment, and individual. Specifically, Stajkovic and Luthans (1979) revealed that employee behavior cannot be fully predicted without considering self-efficacy. Bandura (1977) defines self-efficacy as a person's judgment on his ability to organize and act to achieve the objectives set, as well as his efforts in assessing the extent and generality of strength based on activity and context. Self efficacy is the intrinsic motivation that someone has. Samuel and Chipunza (2009) argued that one's intrinsic motivation will affect the retention of employees.

An employee's self-confidence in completing his job is believed to be a factor that reinforces the positive effect of retention on performance. The effort of the company (environment) in maintaining employees will affect the performance (employee behavior) and will be stronger when there is confidence (individual) of the employees will be competence in carrying out the task. The more personal self-efficacy will further reinforce the positive effect of retention on performance. Conversely, when self-efficacy is low, it further weakens the positive effect of retention on performance.

*Hypothesis 5: self-efficacy moderates the positive influence of employee retention on the performance.*

**Figure 1. Research Model**

## 7. Research Method

The location of this research was done in Medan City, North Sumatra. The subject of this research were star hotels located in Medan city. The population in this study were all employees in star hotels. The samples collected were 200 respondents from 580 the number of registered populations. The variable of retention is an organization's attempt to eliminate intent or retain its employees. This variable was measured by 10 instruments adopted from Kyndt *et al.* (2009) and Hong *et al.* (2012).

Self-efficacy is a person's belief in mastering the job and can produce something positive. This variable is measured by reference to Jones (1986). The compensation variable was measured by reference to Hafanti (2015). There are 10 items representing the compensation variable. Performance is the result of an employee's job function over a certain period that reflects how well the employee meets the requirements of a job to achieve organizational goals. Performance was measured by 4 items, namely quality, quantity, knowledge, and initiative.

The four variables in this study were measured using a 7-point Likert Scale. The data measurement scale used in this research consists of differential semantic scales. Differential semantic scales were developed by Osgood (1952). This scale is used to measure attitudes or certain characteristics that a person has. Thus, it is appropriate to measure the variables used in this study.

Convergent validity was part of the measurement model in SMART-PLS was usually referred to as outer models. There are two criteria to assess whether the outer models (model measurement) is eligible to construct reflective convergent validity, namely loading should be above 0.7 and a significant  $p$  value ( $<0.05$ ) (Hair *et al.*, 2014). Meanwhile, the reliability was tested by Cronbach alpha values. Good

reliability is declared when it has a value of Cronbach alpha > 0.60 (Hair et al., 2014). The analysis in this study was conducted with the help of SMART PLS program.

## 8. Findings

Based on the hypothesis testing results in Table 2, it was revealed that compensation has significant and positive effect on employee performance ( $\beta = 0.122$ ;  $t = 2.282$ ;  $p < 0.05$ ). This result showed that the hypothesis 1 was supported. Furthermore, the testing result of hypothesis 2 indicates direct effect of compensation on the retention, indicated by positive and significant value of coefficient ( $\beta = 0.232$ ;  $t = 3.943$ ;  $p < 0.001$ ). Based on these results it can be concluded that the second hypothesis was accepted. Testing result also revealed the significant and positive effect of employee retention on the performance ( $\beta = 0.437$ ;  $t = 5.963$ ;  $p < 0.001$ ). Thus, hypothesis 3 was supported.

**Table 1. Direct Effect Testing**

Direct Effect	Coefficient	t Statistics	p
compensation → employee performance	0.122	2.282	0.023
compensation → retention	0.232	3.943	0.000
retention → employee performance	0.437	5.963	0.000

Hypothesis 4 aims to test the role of retention as a mediator in the effect of compensation on performance. Baron and Kenny (1986) suggested these four following criteria of the stages of fulfillment of the mediation test:

**Table 2. Baron and Kenny's (1986) criteria on fulfilment of mediating variable**

1	Independent variable is significant to the dependent variable
2	Independent variable is significant to mediation variable
3	Significant effect of mediating variable on dependent variable
4	Independent variable is not significant on dependent variable or the value of the relationship is smaller after mediating variable was included. The insignificant value implies the full mediating role, meanwhile, the smaller value indicates that the mediator mediates partially

The testing results showed the following points:

- The variable of compensation significantly affects on the performance of employees ( $\beta = 0.122$ ;  $t = 2.282$ ;  $p < 0.05$ ).
- Compensation significantly affects on retention ( $\beta = 0.232$ ;  $t = 3.943$ ;  $p < 0.001$ ).
- The variable of retention has significant effect on the employee performance ( $\beta = 0.437$ ;  $t = 5.963$ ;  $p < 0.001$ ) as shown in the results of hypothesis testing 3.

- The variable of compensation has significant effect on employee performance after being inserted the variable of retention ( $\beta=0.101$ ;  $t = 2.925$ ;  $p < 0.05$ ).

**Table 3.** *Indirect Effect Testing*

Indirect Effect	Coefficient	T statistics	P
compensation $\rightarrow$ retention $\rightarrow$ performance	0.101	2.925	0.004
Moderating effect of self-efficacy	-0.058	1.077	0.282

However, the coefficient value is smaller than the influence on the first requirement ( $\beta=0.101 < \beta=0.122$ ). Therefore, it can be shown that the variable of retention mediates partially in the effect of compensation on performance.

Thus, based on the four conditions described by Baron and Kenny (1986), it can be stated that the hypothesis 4 was supported. Furthermore, based on Table 4, the testing result of the role of moderating effect of self-efficacy in the effect of retention on performance. The testing revealed that self-efficacy is not able to moderate the positive effect of retention on the performance of the employee ( $\beta=-0.058$ ;  $t = 1.077$ ;  $p > 0.05$ ). Unlike the four previous hypotheses, the study revealed that hypothesis 5 was not supported.

## 9. Conclusions

The results of this study provide additional empirical results related to how the organization act to improve employee performance, especially on hotel employees in the city of Medan, North Sumatra. These results indicate that the organizational policy in terms of providing adequate compensation has a positive impact on the performance of employees. The result is expected to contribute to practitioners in order to pay attention to aspects of compensation and retention. The compensation aspect may be in the form of salary which is in the nature is an organizational liability.

Moreover, the organization needs to give rewards for outstanding employees and promotion opportunities. In addition, retention programs should also be a concern for practitioners to improve employee performance. In order to retain outstanding employees, the company can focus on the efforts that make employees want to stay in the organization. These include employee training and development, rewards for outstanding employees, job security, and competitive salaries.

Meanwhile, self-efficacy is confirmed to have no role in strengthening the effect of retention on performance. Future research is expected to test the role of external factors such as culture, employee contract status, and organization as a moderating variable to empirically test the effect of retention on performance.

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